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Economic Conditions Governmental Finance United States Securities

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General Business Conditions

THE defense program is steadily extending its grip upon the industries, and the evidence that its effects will be felt more and more in the everyday affairs of the country becomes plainer each month. The fiscal program, after a long period of discussion and surmise, is finally taking shape, with Congressional leaders and the Treasury agreeing that taxes calculated to raise $3½ billions additional revenue in 1942 should be levied. This is more than the general public has been expecting, and people affected will have to rearrange their budgets accordingly.

On May 1 the Treasury launched its effort to induce people to save more money and to lend their savings to the Government, by investing in the new issues of savings bonds announced several weeks ago. These fiscal measures are not only moves to raise money. Their purpose is equally to divert purchasing power from the people into the Treasury, and thus to keep the gathering inflationary influences under control. They represent a demand upon consumers for economy.

In the industrial situation also new measures, which move business further toward a war basis, have been taken. The position of Mr. Henderson as price controller has been expanded and strengthened through the establishment of the Office of Price Administration and Civilian Supply. Priorities and other measures to give precedence to the defense effort are tightening rather than relaxing.

Some observers had hoped that the tight situation in the metals and a few other commodities would ease somewhat by this time, in consequence of greater production, accumulation of inventory by buyers, and measures to check hoarding. The increases in defense appropriations, however, and the commitments made to Great Britain under the Lease-Lend Act, require raising the earlier estimates of needs. Industrial construction—already larger than ever before in our history — is still expanding. It is reported on official authority that additional large contracts will soon be let for new airplane and ordnance plants, shipyards, and other needed facilities, which in time will add their demands to those of the plants now under way.

The British reverses in the Mediterranean have disturbed sentiment and the stock market, but to the industries they represent a call for more arms, more ships, and above all more speed. With new armament factories getting close to production and metal-working capacity being expanded through the completion of more than $50,000,000 worth of new machine tools each month, it is hardly possible for the demand for metals to show much abatement.

Automobile Curtailment Projected

As defense takings of materials increase, and shifts of labor and management to defense work accelerate, non-defense industries have to adapt themselves to the situation. So far they have experienced little interference with operations attributable to priorities, but face the necessity of greater adjustments as time passes. A major development of the month is the agreement by automobile manufacturers to curtail production of 1942 models, beginning next August, by 20 per cent, so that the industry may devote itself more effectively to its defense orders. This will reduce annual output from approximately 5,000,000 vehicles to 4,000,000. In due course similar reductions may occur in other consumers' durable goods.

The General Motors Corporation has also announced that it will not introduce new models for 1943, for which it would customarily begin to plan at this time, inasmuch as the new machine tools and the work of tool and die makers which 1943 models would require must be diverted to the defense effort. It is taken for granted that other automobile companies will follow a like policy.

Unquestionably the country will welcome the action of the automobile producers. It is evidence that in this major industry the switch to armament production is becoming effective. The switch is not sought by the industry, but is a contribution to the common need. If it requires some consumers to forego satisfaction

of the desire for new automobiles all the evidence indicates that they will cheerfully do so. In fact, the sacrifices, if 4,000,000 cars can be produced next season, will hardly be worthy of the term. The industry will produce and sell some 5,000,000 of its 1941 models by next August, following a 4,250,000 car model year in 1940. After these big years the market is well supplied; and 4,000,000 cars will meet replacement demands with a good proportion left over for new buyers.

Obviously, continuation of 1942 models through 1943 will be no real hardship. The motor cars now being produced have never been equalled in comfort, efficiency and economy.

It should not be inferred from this move that the automobile industry will give less support to business after August. On the contrary, it will be giving more employment, paying more wages and using more materials than ever before in its history. Doubtless this will be true of the industrial situation in general, despite adjustments that some lines may have to take in consequence of economy among people bearing the brunt of the higher taxes, inability to get materials, correction of overbuying, or for other reasons.

More Foodstuffs Needed

Further evidence of the spreading effects of the defense and lease-lend program is the shift of the Administration's farm policy, with respect to some of the major foodstuffs. For ten years or more farm policies have been concerned with the support of prices, restriction of production and disposal of surpluses. In wheat, cotton and tobacco, whose export markets have been curtailed, these policies will still rule for the most part. But in other farm products the necessity of supplying food to Great Britain, and of meeting increased purchasing power at home without excessive rise in the cost of living, has now resulted in moves to increase production. Secretary of Agriculture Wickard announced at the beginning of the month that the Government would support prices of pork, dairy and poultry products, for the purpose of encouraging output and building up a government stock. Likewise plans for a vote by farmers on compulsory restriction of corn marketings next Fall have been abandoned, in order to assure plentiful supplies of feed.

Secretary Wickard has also called for greater production of canned and dried foods, and has announced a program of purchases by the Surplus Marketing Administration. Food stocks acquired by the Government will be held for Great Britain, for relief distribution, and for release to the market in case of unwarranted price advances.

It is not the usual thing to welcome interference with the markets by government agencies, which ordinarily is for the purpose of suspending the operation of supply and demand rather than facilitating it, and in most cases is costly and futile. Under present conditions, however, it is clearly desirable to encourage production of the foodstuffs needed. As was stated in this Letter last month, "no war was ever lost by having too much farm production. Abundant supplies provide a cushion against unforeseen demands, possible crop failures or future diversion of farm labor to the industries. In all these ways they are an invaluable protection against inflationary forces."

Under normal conditions the function of encouraging production in advance of requirements is performed by the speculator, who foresees the demands and bids up the markets. The Government is now undertaking this function, and of course has the resources to perform it more effectively, including a nationwide organization to advise farmers in their production plans. Canned tomatoes are among the food supplies wanted, and the Department of Agriculture asks canners to pack 15,000,000 cases more this year than last, a 62½ per cent jump. It agrees to buy the 15,000,000 cases within sixty days of packing on a price basis which will permit growers to be paid from $2.75 to $3 a ton more for their tomatoes than last year.

No agency except the Government could make such a move to induce an increase in tomato growing, and no other agency would incur such a risk of loss. It should be superfluous to add that the only possible justification for the government's assumption of such a risk is the national policy of aid to Great Britain.

Policies Support Each Other

All of these developments follow naturally from the intensification of the war and the defense effort, and the desperate call for supplies from the British people. The policies described are consistent with each other, if administered in accord with common principles.

The paramount needs for the defense program are, first, that production of all essential commodities should be lifted to the highest possible level: second, that to the utmost practicable extent, and as rapidly as they can be devoted to defense purposes, the necessary production and income should be diverted to the Government. The reduction in automobile output will release labor and materials for defense work. The purchasing power which would be available for the automobiles that will not be produced should be diverted to the Treasury to pay for the tanks, airplane motors and guns which the automobile manufacturers will be making. This is the function of the higher taxes and the sale of the savings bonds. Mr. Henderson's function of policing the markets and combating inflationary influences

through direct measures likewise fits into the general effort.

All these steps interact and support each other. Their objective is not only to carry out the defense program efficiently and finance it economically, but to prevent a price inflation such as has occurred during every previous war. The moves against the inflationary forces should come from all sides.

Price Control Measures

Undoubtedly there is much room for difference of opinion as to the details of the measures now proposed and their administration. The general acceptance of price controls should not obscure the fact that prices themselves are but symptoms of underlying conditions. The sound way to keep prices down is to increase production and economize in consumption. Where supplies are short and demand is swollen by desire to lay in stocks, it would be against common sense to allow the distribution of commodities among buyers to be worked out by their willingness to outbid each other, rather than according to the relative importance of the various needs. Thus price controls necessarily accompany priorities. On the other hand, the surest way to stimulate production is to permit producers to earn a profit, to the point of being able to lay aside reserves against the hard times that may come again. It will not escape notice that while industrial prices are in general restricted despite increased costs, the effort to persuade the farmer to produce more is supported by promise of greater returns.

These considerations give Mr. Henderson a field of operation in which great wisdom and flexibility will be required. On assuming his new office he made a commendable statement of principle in which he said, as reported in the press, that maintenance of a stable price level depends as much on a "smooth relationship" of supply and demand as on the actual mechanics of price fixing. He said: "Legal penalties are not a substitute for additional supplies in holding prices down. If we get to the point where we are relying on legal punishment then we will have reached the top of our productive effort."

Mr. Henderson's action in putting a ceiling on steel prices at present levels, following the wage increase of 10c an hour granted to steel workers, has been criticized by the higher-cost steel companies, undoubtedly with good reasons and with full propriety. He has found support, however, in other quarters of the industry, on the ground that prices will remain open for review, and that a period of experience under the new wage rates is desirable to determine what costs will be. The coal operators are not being subjected to such restrictions, but will be allowed to raise prices to cover their wage increases.

Wage Increases General

The rise in wage rates has been accelerating for some months. It is now almost general through the industries, and is comparable to the increases in the early part of 1937. In that year the advance in costs and prices was instrumental in getting the situation out of balance and starting the depression. This year it will have no such immediate effect, for the industrial activity does not depend on the normal exchange of goods between the various occupations, but upon government orders.

However, costs will be increased by the higher wages, except as offset by further increases in productivity, and the rise in costs will have to work itself out—if not by checking business then by forcing price increases. To be sure, some employers may be able to absorb the higher costs, but this is never true of all. If the wage increases meant a lasting gain in the purchasing power of the workers affected, without cost to their neighbors and fellow workers in other occupations, they would be welcomed on all sides. Will it work this way? All those who do not have equivalent increases, but have to pay higher living costs, will be penalized, and this includes a great many people. They will be able to buy less of the products of workers who get the higher wages. What will the effects be, especially after the defense spending passes its peak and begins to subside? Or will the advances simply move around the circle of wages, prices and cost of living until relations between the various groups are about the same as before, but with the difference that all are on stilts as in 1920, 1929 and 1937?

It is a mistake to assume that the higher wages will have no inflationary effects where they are absorbed by the employer without passing them on in prices. In comment on the increases it is often pointed out that they will cost the companies comparatively little, since a substantial part of every additional dollar paid will be offset by reduced corporate income and excess profits taxes. This comment shows the effect on the Treasury, since few of the recipients of the wage increases will pay income taxes, as demonstrated in the next article in this Letter. Instead of being diverted into the Treasury, therefore, this part of corporate earnings will be disbursed as buying power available for the purchase of goods. The inflationary forces are strengthened, and the problem of control is made more difficult.

All elements of the population want to avoid the inflationary spiral, and all must bear their share of the responsibility. If one group undertakes to improve its position at the expense of other groups, the move tends to become general. Most students of the inflationary danger believe the spiral is more likely to start from rising labor costs than from any other point.

New Taxes and Savings Bonds

Brief reference has already been made to the forthcoming tax measure. Secretary Morgenthau arrived at the figure of about $3,500,000,000 additional revenues annually, which the tax proposals are designed to raise, by applying the formula which he had previously suggested as desirable, namely, that two-thirds of all expenditures should be raised by taxes and one-third by borrowing. He estimated the probable expenditures in the fiscal year 1942 at $19,000,000,000, plus or minus 10 per cent. He estimated revenues under present laws at $9,223,000,000, which is an increase of $948,000,000 over the original budget estimate, reflecting the rapid rise of national income. Subtraction of this estimate from two-thirds of $19,000,000,000, or $12,667,000,000, leaves $3,444,000,000 as the tax goal.

Both the Treasury and the Congressional Joint Committee on Internal Revenue Taxation have prepared schedules designed to raise this amount. The features of the Treasury proposals are general increases in individual income taxes, especially on incomes of $3,000 to $25,000, and without lowering exemptions; surtaxes of 5 per cent on corporate income under $25,000, and 6 per cent over $25,000, which would raise the effective corporate tax rate in the latter bracket to 30 per cent; changes to increase the excess profits tax; increases in gift and estate taxes; and increases in excise levies estimated to yield $1,233,000,000.

The Joint Committee schedules would impose moderately lower rates than the Treasury on incomes up to $20,000, and would levy a greater variety of new excise and consumption taxes to make up the difference.

The following table shows the personal income rates under the two proposals, compared with those of the existing law:

Taxes to be Paid by Married Persons with No Dependents and Maximum Earned Income Credit

Net Inc. Before Personal Exemption	Amount of Tax* Present Law	Amount of Tax* Treasury Proposal	Amount of Tax* Congress Proposal	Effective Rates %* Present Law	Effective Rates %* Treas'y Proposal	Effective Rates %* Cong. Proposal
$2,500	$11	$72	$44	.4	2.9	1.8
3,000	31	152	97	1.0	5.1	3.2
4,000	70	312	202	1.8	7.8	5.1
5,000	110	506	352	2.2	10.1	7.0
6,000	150	700	502	2.5	11.7	8.4
8,000	317	1,131	889	4.0	14.1	11.1
10,000	528	1,628	1,364	5.3	16.3	13.6
12,500	858	2,316	2,013	6.9	18.5	16.1
15,000	1,258	3,073	2,853	8.4	20.5	19.0
20,000	2,336	4,800	4,756	11.7	24.0	23.8
25,000	3,843	6,824	7,055	15.4	27.3	28.2
50,000	14,128	19,540	20,794	28.3	39.0	41.6
75,000	27,768	35,127	36,689	37.0	46.8	48.9
100,000	43,476	52,474	54,124	43.5	52.5	54.1
500,000	330,156	346,122	347,598	66.0	69.2	69.5
1,000,000	717,584	738,086	739,598	71.8	73.8	74.0
5,000,000	3,916,548	3,937,050	3,938,598	78.3	78.7	78.8

*Includes 10 per cent defense tax.

Vigorous Tax Policy Wanted

All surveys of public sentiment have shown that the country wants a vigorous tax policy. No expert knowledge of public finance is necessary to show people that the armaments have to be paid for, or that more of the increasing national income should be drawn on for that purpose. Over and over again it must be repeated that the equipment of the armed forces can only be accomplished by surrendering the necessary share of the industrial output of the country. Consumers cannot use for their own wants the productive facilities that defense requires, and no financial expedient will enable them to do so. Their choice is either to give up the equivalent part of their income through taxes or loans, or to have it taken away through inflation which will diminish its purchasing power.

It should also be emphasized over and over that the productive facilities are not fixed, and given time can be increased, to the limit of the labor, working time, and raw materials available. People can afford to pay higher taxes when the industries are busy, and still have a better living than when the industries are depressed. The national income has had a 15 per cent increase, equal to ten billion dollars annually, since the Summer of 1939, and there are still great productive resources to be drawn on. How the taxpayers fare as consumers will depend upon how they work as producers.

In the long run all the cost of defense must be met by taxation. However, the principle of deferring part of the taxes by borrowing is sound. Wise statesmanship will take account of psychological as well as economic considerations. It will not levy taxes so heavy as to destroy the incentive to devote all energies to production, or to drain the fund of savings which is necessary to maintain the industrial organization and support production.

Both tax proposals provide for higher levels on the upper income brackets, although present rates on these brackets discourage enterprise. The burdens imposed upon new business risks will now be even more restrictive, for before paying anything to the investor the earnings of the enterprise will have to bear a still larger normal corporate tax and surtax, increased excess profits taxes, and then will come the increased taxes on the stockholder's share of the earnings. Most new industrial undertakings nowadays are in connection with the defense program.

At the other end of the scale, it would be even worse to levy taxes which would deprive people of common necessaries and comforts, and impair their health and efficiency.

The proposed estate taxes provide for lower exemptions and drastic increases in the rates upon medium as well as large estates, including proceeds of life insurance. Such taxes bear

little relation either to the rise in national income or to the principle of checking inflationary tendencies. They encroach upon the savings of the community, rather than its spending. If savings are unwisely taxed the loss to future generations will be greater than if we bequeath them a greater debt but also a greater fund of capital.

Tests of Tax Effectiveness

Differences of opinion concerning the proposed tax measures will center upon the question of their effectiveness for their primary purposes. Considered as revenue producers, it is agreed that they will raise the money. Tax studies have indicated that, apart from taxes on business earnings, more revenue could be raised more effectively and economically from the so-called middle brackets than from other sections of the population, and equitable increases on these brackets are clearly the desirable starting point for the program.

The second test of the new taxes will be their effectiveness in checking private spending, to whatever extent may prove necessary in areas where consumer wants conflict with defense needs. Mr. Morgenthau presents this as a primary objective. Private spending for consumption is not a privilege of the rich or of people in the middle brackets, and if the objective is to be realized all consumers will manifestly have to bear a share of the burden.

We publish herewith a table compiled in part from a report of the National Resources Committee and in part from the official statistics of income for 1936. These tabulations together show the distribution of income of "consumer units" (i.e., families and single individuals each counted as one unit) by various income brackets, and also the federal income taxes paid in each bracket. Later tax statistics are available, through 1938, but the other figures are not, and the 1938 tax figures would not change the distribution materially. The showing of these figures is that consumer units with incomes below $3,000 had 69 per cent of the national income but paid only 2.3 per cent of the federal income taxes (which of course is exclusive of indirect levies). All those below $5,000 (97.7 per cent of the number) had 80 per cent of the income but paid only 5 per cent of the taxes. They buy the great bulk of the goods consumed in the country, approximately 90 per cent according to various studies.

Moreover, many of the people in the lower income groups, the industrial workers specifically, are having increases in income which make them buyers on still a larger scale of automobiles and similar goods whose production may be restricted by the defense program. In March, factory payrolls were 46 per cent higher than at the outbreak of the war, and more is to come, reflecting both greater employment and higher pay to employed workers.

Direct or Indirect Levies?

To turn part of the increased income of factory workers into the Treasury, both tax proposals rely almost wholly upon excise taxes. As the schedules above given show, they would levy income taxes of only 1.8 or 2.9 per cent on net incomes of married persons getting $2,500 before personal exemption, while those below $2,000 would pay nothing. In the case of industrial workers particularly the income taxes will obviously represent but a small part of the increase in income. Whether excise taxes, together with the economies enforced upon the middle brackets, will check private spending as necessary is a question upon which all the evidence should be considered carefully. For this is the heart of the effort to control the inflationary influences.

There are good arguments for increasing excise taxes now. It is wholly proper that articles which are unquestionably luxuries should bear a tax, and a substantial one when the cost is high. Excise taxes are equally proper and effective when laid upon articles which, although comforts and conveniences rather than true luxuries, compete directly with defense industries for labor and materials. Ordinarily, however, excise taxes apart from liquor, tobacco and gasoline are not major revenue producers, and in many the expense and difficulty of administration are relatively high. They bear inequitably upon the industries, and upon the people. A general manufacturers' sales tax

Summary of Individual Incomes and Federal Tax Payments in 1935-36

Income Groups ($000)	Families & Single Individuals Number	%	Cum. %	Aggregate Income (Millions)	%	Cum. %	Federal Normal Tax & Surtax (Millions)	%	Cum. %
Under 1	18,358,949	46.5	46.5	$10,807	18.2	18.2	$ †	*	*
1 to 2	13,920,349	35.3	81.8	19,573	33.0	51.3	14	1.1	1.2
2 to 3	4,434,085	11.3	93.1	10.577	17.9	69.1	14	1.1	2.3
3 to 4	1,354,078	3.3	96.4	4,599	7.8	76.9	15	1.2	3.6
4 to 5	464,191	1.3	97.7	2,045	3.4	80.3	17	1.4	5.0
5 to 10	595,908	1.5	99.2	4,092	6.9	87.2	79	6.5	11.5
10 to 25	260,430	0.6	99.8	3,811	6.4	93.7	176	14.5	26.0
25 to 100	64,923	0.2	100.0	2,660	4.5	98.1	407	33.5	59.5
100 to 1,000	5,300	*	100.0	938	1.6	99.7	414	34.1	93.6
Over 1,000	87	*	100.0	157	0.3	100.0	77	6.4	100.0
Total	39,458,300	100.0	100.0	$59,259	100.0	100.0	$1,214	100.0	100.0

Source: Compiled from National Resources Committee Report for 1935-36 and Treasury Department Statistics of Income for 1936, Part I. *Less than 0.05 per cent. †Less than $500,000.

upon finished articles entering into channels of consumption would have much in its favor, but would fall disproportionately upon low income groups.

Direct income taxes, on the other hand, can be levied equitably in proportion to ability to pay, they leave consumers' choice unrestricted, and people are more aware of the taxes they pay.

One of the arguments against further lowering of personal exemptions is that the Treasury would be exploring new tax sources without previous indication of either the tax yields or the consequences to business. Possibly, however, this is less an argument against the move than in favor of it. The Treasury has never been in such need of money, and the time is appropriate to feel the way into new ground. The practical difficulties, namely, multiplication of returns and increased cost of collection, may not be as great as feared. Married taxpayers with gross income of $2,000 or over are now required to file returns, although few of those with incomes near that figure pay a tax, having other exemptions in addition to their $2,000 deduction and earned income credit. For the year 1938, more non-taxable than taxable income tax returns were filed with the Treasury, 3,061,686 against 2,995,034. The lowering of the exemption last year is expected to bring a total of 16,000,000 tax returns into the Treasury during 1941, and doubtless less than half will pay any tax. It seems unlikely that the machinery would be more difficult to handle if the exemptions were lowered so that more of these non-taxable returns were accompanied by a check.

The gross income or payroll tax is another which might be explored in the emergency. It would present collection difficulties in many groups (farmers, transient workers, etc.) but it could be put into effect promptly and collected at the source. It would have universal coverage and would yield a heavy revenue.

Mr. Morgenthau's Plea for Economy

As one of the objectives of tax policy, it is desirable that people should be aware of the taxes they pay. If they are aware, they are more likely to throw their influence on the side of economy in non-defense expenditures. In testimony before the House Ways and Means Committee on April 24 Secretary Morgenthau urged such economies. Asked for specific suggestions he referred to the Senate version of the 1942 agricultural appropriations bill which includes an item of $450,000,000 for farm parity payments, representing increases over the House bill of $150,000,000 in payments on 1941 crops and $88,000,000 on payments on 1942 crops. The bill is now in conference. He referred also to the $500,000,000 for soil conservation payments, the $300,000,000 for the Civilian Conservation Corps, and $370,000,000 for the National Youth Administration. Of the two latter, he said that they "are taking boys over 21 just as though we did not have the Army taking them."

Mr. Morgenthau should have general support in recommending that these appropriations be re-examined. There is a flat contradiction of policy between raising taxes in order to repress private purchasing power, and then disbursing the money for non-defense uses.

The Defense Savings Issues

The offering of new savings securities by the Treasury, beginning May 1, supplements the tax program. Subscriptions to the new issues will divert spending power into the Treasury just as effectively as taxes, provided the funds for the subscription are saved out of income. This is a qualification to be kept in view. Switching investments does not increase the total savings available to the Government, for every sale requires a buyer. The total can be increased only out of new profits and savings.

Four types of new issues are offered:

1. **Series E defense savings bonds:** These will take the place of the present baby bonds, but will be available only to individuals and in yearly amounts of not more than $5,000. They will be sold at 75 per cent of maturity value, in denominations as low as $25, and will be non-transferable; but may be redeemed at the Treasury on an accelerating scale of values, and yield about 2.9 per cent if held to maturity in ten years. They are designed chiefly for persons of small income.
2. **Series F savings bonds:** Like the above, this is also a discount bond, but is intended for larger investors. It will be available to any purchaser, including corporations, trustees, pension funds, etc., as well as individuals, in yearly amounts not exceeding $50,000 in total or in the combined aggregate with Series G. Purchasable at 74 per cent of face value, and in denominations as low as $100, the yield is about 2.53 per cent if held to maturity in twelve years. Like defense savings bonds, they will be non-transferable, but may be redeemed at the Treasury at accelerating rates.
3. **Series G savings bonds:** These are like Series F bonds, except that they will be interest-bearing instead of discount bonds, designed to appeal to investors requiring current income. Yearly amounts are similar to Series F. Interest will be at 2½ per cent, payable semi-annually by check, with redemption values of principal scaled at less than par in order to encourage holdings of the bonds to maturity.
4. **Postal savings stamps:** These are to be issued in small denominations (as low as 10 cents) and yield no interest, but may be accumulated and converted into Series E bonds at an advantageous rate. They are intended to reach the smallest savers.

What differentiates these bonds from the open market issues is that they are designed to stay in the hands of the purchasers. They are redeemable at the Treasury, but non-negotiable, therefore cannot be assigned as collateral against loans and carried by borrowing from banks. They will be bought to all practicable purposes out of true savings.

How much the Treasury may raise through the sale of these securities is difficult to estimate in advance. The investor's rate of return compares favorably with that from other sources. The redemption privileges are a safeguard against losses such as investors incurred

who had to sell their Liberty bonds in the market after the last war. Since there are fewer restrictions on purchases and a sales effort will be made, it seems certain that sales will considerably exceed those of the old "baby bonds." These bonds, which were similar to the new Series E, were first offered in May 1935, and the effort to sell them has been of modest proportions. Over $3,600,000,000 have been sold and last year the volume amounted to $986,000,000.

As compared with the great security issues of the first World War, people in the middle and upper brackets will doubtless feel less able to subscribe to the current issues, since they are to bear much higher taxes than in the last war. This emphasizes the importance of subscriptions by those whose increases in income will not be taken away by taxes.

The campaign to sell the new issues will be vigorous, but without high-pressure tactics. Banks and savings and loan associations have offered their services to the Treasury to act as agents along with the postal system. The higher national income and the people's desire to aid the defense program are expected to bring a quick and sustained response.

First Quarter Profits

Reports for the first quarter issued during the past month by leading corporations show that the increase in industrial operations, to a level 20 per cent above the first quarter of last year, was accompanied in a majority of cases by an increase in net profits, despite the rise in cost of materials, wage rates and income taxes. Many representative manufacturing companies operated at capacity throughout the quarter and established new high records in volume of sales. Leading railroads and public utility companies also reported marked gains in gross and net income. There were numerous exceptions, however, to this favorable trend.

A tabulation of the reports of 345 leading companies in the manufacturing, mining, trade and service industries shows combined net profits, less deficits, of approximately $377,000,000 after taxes. This represents an increase of 2 per cent over the $370,000,000 reported by the same companies in the fourth quarter of 1940, and an increase of 17.5 per cent over the $321,000,000 total in the first quarter a year ago.

Total outstanding capital and surplus of the group aggregated $12,388,000,000 at the beginning of this year, upon which the first quarter profits were at an annual rate of 12.2 per cent, compared with a rate of 10.5 per cent on a somewhat smaller net worth in the first quarter of 1940. The accompanying summary gives the results for major industrial groups. As pointed out heretofore, the large companies which issue prompt quarterly reports, and in this tabulation had an average net worth of $36,000,000 per company, provide a useful in-

PROFITS OF LEADING CORPORATIONS FOR THE FIRST QUARTER

Net Profits Are as Reported, After Depreciation, Interest, Taxes, and Other Charges and Reserves, but Before Dividends.—Net Worth Includes Book Value of Outstanding Preferred and Common Stock and Surplus Account at Beginning of Each Year.

(In Thousands of Dollars)

No.	Industrial Groups	Net Profits First Quarter 1940	Net Profits First Quarter 1941	Per Cent Change†	Net Worth January 1 1940	Net Worth January 1 1941	Annual Rate of Return % 1940	Annual Rate of Return % 1941
6	Baking	$ 3,771	$ 3,309	—12.3	$ 245,762	$ 247,680	6.1	5.4
12	Food products—misc.	15,488	16,868	+ 8.9	528,091	533,533	11.7	12.6
9	Beverages	3,800	3,830	+ 0.8	136,493	143,230	11.1	10.7
13	Textiles and apparel	3,374	3,689	+ 9.3	103,947	106,977	13.0	13.8
12	Paper products	3,770	3,421	— 9.3	163,567	169,393	9.2	8.1
25	Chemicals, drugs, etc.	53,249	50,813	— 4.6	1,313,651	1,350,148	16.2	15.0
14	Petroleum products	34,918	26,621	—23.8	2,011,084	1,977,593	7.0	5.4
23	Stone, clay and glass	7,563	11,254	+48.8	385,810	393,604	7.8	11.4
1	Iron and steel—U. S. Steel	17,114	36,560	+	1,314,807	1,356,875	5.2	10.8
27	Iron and steel—other	22,916	46,078	+	1,515,358	1,513,499	6.0	12.2
9	Building equipment	3,334	4,976	+49.3	206,496	200,645	6.4	9.9
11	Electrical equipment	18,406	21,372	+16.1	565,822	578,163	13.0	14.8
23	Machinery	6,869	9,902	+44.2	267,070	280,671	10.3	14.1
7	Office equipment	4,253	4,567	+ 7.4	135,699	138,221	12.5	13.2
11	Nonferrous metals	8,641	11,476	+32.8	419,373	422,965	8.2	10.8
1	Automobile—Gen. Motors	67,028	64,598	— 3.6	1,053,560	1,085,016	25.4	23.8
5	Automobile—other	877	1,633	+86.2	67,301	71,227	5.2	9.2
24	Auto equipment	11,400	12,788	+12.2	215,939	232,276	21.1	22.0
11	Railway equipment	8,487	8,888	+ 4.7	360,310	366,576	9.4	9.7
25	Metal products—misc.	7,750	12,370	+59.6	201,376	215,910	15.4	22.9
26	Misc. manufacturing	4,511	7,039	+56.0	251,720	257,563	7.2	10.9
295	Total manufacturing	307,519	362,052	+17.7	11,463,236	11,641,765	10.7	12.4
6	Coal mining	614*	763*	+24.3	61,437	59,254	4.0	5.2
9	Metal mining	4,023*	4,600*	+14.3	190,190	189,832	8.5	9.7
11	Mining, quarrying—misc.	5,215*	4,740*	— 9.1	173,800	171,899	12.0	11.0
14	Trade (wholesale and retail)	1,559	2,408	+54.5	194,578	200,577	3.2	4.8
10	Service and construction	2,254	2,809	+24.6	122,319	124,289	7.4	9.0
345	Total	$321,184	$377,372	+17.5	$12,205,560	$12,387,616	10.5	12.2

D- Deficit. *Before certain charges. †Increases or decreases of more than 100 per cent not computed.

dication of earnings trends, but are not representative of the average rate of earnings for business as a whole. The latter may be determined only from the official "Statistics of Income" compiled by the Treasury Department from tax returns.

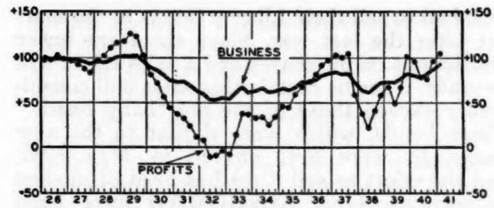
It will be seen that the largest gain in net profit was in the iron and steel group, which operated virtually at capacity throughout the first three months, as compared with 72 per cent of capacity in 1940. The figures for the first quarter, of course, cannot be taken as a measure of probable results for the current year as a whole, since they do not reflect the general increase in wage rates granted last month, the fixing of maximum prices on steel products, or the curtailment of operations in some centers caused by the coal strike. Moderate to sharp gains in profits were made also by many companies in the machinery, equipment and other metal product industries, which have been operating at peak levels and still have large backlogs of unfilled orders.

The course of profits was fairly steady in such consumers' goods industries as baking, food products, beverages, textiles and apparel, paper products, chemicals and drugs, as well as in automobiles. Many representative producers in these lines were able to absorb the increased costs by an increase in sales, so that profit margins were affected only moderately.

In the case of a considerable number of companies in different lines, however, the rapidly rising costs for materials, labor and taxes, combined with some interruptions due to strikes, have already caught up with the marked expansion in volume of business, and thereby reduced profits below those of last year. Among well known manufacturing companies which are handling large national defense contracts in addition to their normal business but had lower net profits after taxes might be mentioned: Allis-Chalmers Mfg. Co., American Steel Foundries, Bethlehem Steel Corp., E. I. du Pont de Nemours & Co., Electric Auto-Lite Co., General Electric Co., General Motors Corp., Hercules Powder Co., International Business Machines Corp., Glenn L. Martin Co., Otis Elevator Co., and Studebaker Corp.

The generally upward trend of earnings shown in the manufacturing industries was also indicated for the mining, trade and service groups by the limited number of quarterly reports available in these lines. Figures for the coal mining companies do not reflect either the strike in the bituminous industry which began at the close of the quarter, or the proposed increase in wage rates.

The quarterly course of profits over a period of years is shown by our index computed from rate of return on net worth of 200 leading corporations, which is given on the accompanying chart, together with the Federal Reserve



Quarterly Index of Industrial Corporation Profits and the Federal Reserve Bank of New York Index of Production. 1926 = 100

Bank of New York index of production. This index differs from that of the Federal Reserve Board in that it is adjusted to allow for the long-term trend, as well as for seasonal variation.

The Rise in Taxes

The sharp rise in income and excess profits taxes during the past two years may be seen from the tax reserves set up for the first quarter. Ninety manufacturing companies whose reports contained expense details showed the following charges:

Income and Excess Profits Tax Reserves of 90 Leading Manufacturing Corporations

First quarter	1939	$23,143,000
" "	1940	41,392,000
" "	1941	151,912,000

These totals indicate only roughly the several-fold increase in federal income and excess profits taxes during the past two years, since they cover but one-third of the manufacturing companies which have published first quarter reports. Moreover, there is a known lack of uniformity in the accounting treatment of taxes, some companies this year having applied the existing rates, and others the higher rates now under consideration, while a few companies set aside special reserves for contingencies including additional taxes. At the same time, some companies when presenting their first quarter reports for 1941 gave revised figures of taxes and net income for the first quarter of 1940, so as to give effect to the retroactive revenue acts passed last year and thereby make the quarterly figures more nearly comparable.

Change in First Quarter Sales

Sales figures issued by leading manufacturing corporations show highly uneven changes as compared with the first quarter of last year, ranging from increases of more than 100 per cent to moderate decreases. A group of 40 large companies given in the accompanying list had aggregate sales of approximately $1,478,000,000 in the first quarter, which was 31 per cent larger than the $1,127,000,000 in the first quarter last year. These figures represent shipments or sales billed, and in most cases are less than the orders received or sales booked during the same period.

% Change in First Quarter Sales, 1940-1941

Manufacturing		Retail Trade	
Air Reduction Company	+44.3	merican Stores Co.	+ 7.2
Allis-Chalmers Mfg.	+ 9.2	Barker Bros. Corp.	+13.3
Amer. Steel Foundries	+19.4	Bond Stores	+22.3
Atlantic Refining Co.	— 3.9	Colonial Stores	+19.9
Atlas Powder Co.	+65.7	Consol. Retail Stores	+ 6.1
Baldwin Loco.Wks.	+45.9	Crown Drug Co.	+ 2.3
Beatrice Creamery Co.	+10.2	Edison Bros. Stores	+ 6.6
Boeing Airplane Co.	+95.2	Marshall Field & Co.	+ 6.9
Burroughs Adding Mach.	+32.4	M. H. Fishman Co.	+ 7.5
Caterpillar Tractor Co.	+65.3	W. T. Grant Co.	+ 8.5
Colo. Fuel & Iron	+38.1	H. L. Green Co.	+ 0.3
Container Corporation	+24.6	Interstate Dept. Stores	+14.7
Continental Baking Co.	+ 3.0	Jewel Tea Co.	+30.0
Crown Cork & Seal Co.	+18.1	S. S. Kresge Co.	+ 1.6
Curtis Publishing Co.	+ 6.2	S. H. Kress & Co.	+ 8.4
Doehler Die Casting	+93.9	Kroger Groc. & Bak.	+ 9.9
E. I. du Pont & Co.	+39.0	Lane Bryant, Inc.	+10.5
Eastman Kodak Co.	+24.0	Lerner Stores Corp.	— 1.1
General Electric Co.	+51.1	Lincoln Stores	+10.1
General Foods Corp.	+11.8	McCrory Stores Corp.	+ 1.9
General Motors Corp.	+41.7	McLellan Stores	+ 5.9
Hazel-Atlas Glass Co.	+11.7	Montgomery Ward	+12.5
Hercules Powder Co.	+30.2	G. C. Murphy Co.	+ 7.2
Johns-Manville Corp.	+44.8	Natl. Tea Company	+ 2.7
Kimberly-Clark Corp.	+ 4.3	Neisner Brothers	— 3.4
Link-Belt Co.	+46.6	J. J. Newberry Co.	+ 9.0
Lone Star Cement	+47.2	J. C. Penney Co.	+10.0
Glenn L. Martin Co.	+91.5	Peoples Drug Stores	+11.0
Mead Corporation	+17.0	Rand's	+37.1
Natl. Cash Register	+ 3.3	Reliable Stores Corp.	+29.1
Natl. Supply Co.	+19.3	Rose's 5-10-25c Stores	+17.8
Otis Elevator Co.	+18.5	Safeway Stores, Inc.	+ 8.6
Sharon Steel Corp.	+52.7	Sears, Roebuck & Co.	+25.7
Shell Union Oil Corp.	— 6.0	Spiegel, Inc.	— 9.8
Skelly Oil Co.	+20.0	Sterchi Brothers	+28.0
Studebaker Corp.	+ 4.5	Union Premier Food	+ 8.2
Tide Water Assoc. Oil	— 1.0	Un. Cigar-Whelan Str.	— 8.3
Union Bag & Paper	+24.1	Walgreen Company	+ 8.3
Union Oil Co.	+ 0.9	Western Auto Supply	+24.5
Wesson Oil & Snow.	+39.2	F. W. Woolworth Co.	+ 2.7

A group of 40 chain store, department store and mail order organizations, also given in the list, had aggregate sales of $898,000,000 in the first quarter of this year against $809,000,000 last year, a gain of 11 per cent.

Railroad and Utility Earnings

Gross revenues of the class 1 railroads during the first quarter were over 16 per cent above those of last year and the highest for any corresponding period since 1930. Despite an increase in operating expenses and taxes, there was a sharp increase in net railway operating income. A substantial balance after interest charges was indicated for the first quarter this year, in contrast with a net deficit a year ago. Results for the second quarter, however, have been affected seriously by the coal strike.

A group of 25 large public utility systems supplying electricity, gas and other services and reporting for the twelve months ended March 31st showed an increase of approximately 5 per cent in operating revenues as compared with the year previous. Because of a rise in operating expenses and taxes, the increase in net income was but 1 per cent.

The New British Budget

The financial burdens and fiscal problems of the British people should arouse more than sympathetic interest in this country, in view of our own problems. Like other democracies Great Britain moved slowly, far too slowly in the opinion of critics of the Chamberlain Government, in total mobilization for war. It does not behoove people in this country to offer criticism, for our own brief experience has shown the difficulty of turning industries overnight to armament production, and of even comprehending all the problems involved. But in the light of events no one now questions the inadequacy of the British program during the first nine months of war. When, after six months of "phony war," the original 1940-41 budget was introduced a year ago, the London Economist protested that "if we spend at this rate we shall lose the war."

The Dunkirk disaster marked the turning point in British policy. With cost a secondary consideration the budget was raised and the war effort redoubled. The fiscal year ended on March 31 last, and the budget for the new year, introduced April 7, is the visible measure of Britain's desperate crisis and the grimness of her effort. Both the expenditures provided (£4,207,000,000) and the taxes imposed are by far the heaviest in British history.

So far as can be done through fiscal measures, the new budget is the most forceful move yet made to repress inflationary influences. The task of the Treasury is not merely to find money and spend it. As Sir Kingsley Wood, now Chancellor of the Exchequer, told the Commons last Summer, the budget must also aim at control of public purchasing power, and "the problem of financing the war is in the main the problem of directing spending power from all sections of the population into the hands of the State."

Of course this diversion of income is but the outward sign of the diversion of production to war purposes. Mr. Ernest Bevin, the Minister of Labor, or Sir Andrew Duncan, the Minister of Supply, might rephrase Sir Kingsley's statement as follows: "The problem of *carrying on* the war is in the main the problem of directing *production* from all sections of the population into the hands of the State." This emphasizes the identity of the two problems. While income is being rerouted, controls over production and rationing of consumption are being extended. A writer in the January issue of the London Banker, Mrs. Joan Robinson, summarizes the matter as follows:

> . . . for it is necessary not only to hold back from the market the 20 per cent of additional purchasing power placed in our hands by Government outlays, but, further, to reduce demand in proportion to the 25 per cent decline in real resources available for civilian consumption. We may be a nation of 40 million Churchills, but we should need to be a nation of 40 million archangels to save at such a rate without compulsion.

The Growth of Expenditures

The original 1940-41 British budget put expenditures at £2,667,000,000. Actual expenditures for the year were £3,867,000,000, which was nearly £1,200,000,000 more than was spent

in 1917-18, the peak year of the first World War. By the January-March quarter expenditures approached a rate of £4,800,000,000 per year ($19,200,000,000 at the current rate of exchange). At the latter rate, Great Britain was diverting almost 60 per cent of her current national income into the war effort (including civil government expenses), but still less than Germany, whose similar costs were reported to have absorbed over 70 per cent of her national income in her last fiscal year.

According to Sir Kingsley Wood, the cost of the war in the present fiscal year 1941-42, will be far beyond £5,000,000,000 ($20,000,000,000), if the value of the supplies to be received from the United States under the Lease-Lend Act is included. The full magnitude of this figure — inconceivable a few years ago — will be understood better if allowance is made for the fact that Great Britain's population is only one-third that of the United States, and that her material resources are relatively even smaller.

The Lease-Lend Act relieves the pressure upon the British economy to a very helpful extent. Nevertheless, even the raising of what Sir Kingsley budgeted as "domestic and Empire expenditures" during the 1941-42 fiscal year, £4,207,000,000, will require exploitation of every possible type of revenue, stimulation of savings, and investment of all current savings in government securities, if a rising inflation is to be repressed.

The Fiscal Program

It will be seen from the accompanying tabulation that tax revenues in 1940-41 amounted to £1,409,000,000, and although larger than originally estimated, covered but 36 per cent of expenditures. They represented but 19 per cent of the estimated national income, a proportion which is surprisingly small, but is held down in part by the one-year lag between income expansion and income tax payments. Germany, however, is estimated to be collecting over one-third of her national income in taxes; and the British percentage is no larger than that of the United States last year.

In the current fiscal year, 1941-42, taxes of individuals are to be raised by lowering personal exemptions and the earned income allowance, and by raising the basic income tax rate to 50 per cent. The changes are designed to bring some 2,000,000 more people within the range of the income tax, and to hit especially at small incomes. Personal exemption of married persons is reduced to £140 ($560) and of single persons to £80 ($320). The tax of a married man with two children and an income equivalent to $2,000 will be $305; on an income of $5,000 the tax will be $1,655. As for the effect of surtaxes in the higher brackets, Sir Kingsley gave an example in which he said

British Budgets and National Income
(In Millions of Pounds Sterling)

Fiscal Years (Apr.-Mar.)	1938-39 Actual	1939-40 Actual	1940-41 Actual	1941-42 First Est.*
Expenditures:				
Debt service	244	247	230	272
War services	400	1,141	3,220	3,500
Others	424	429	417	435
Total expenditures	1,068	1,817	3,867	4,207
Revenues:				
Income tax	336	390	524	1,786
Customs and excise	341	400	529	
Others	250	259	356	
Total revenues	927	1,049	1,409	1,786
Deficit	141	768	2,458	2,421
National Income (estimates)	5,300	6,100	7,400	9,000
Expenditures % of Nat'l Inc.	20	30	52	47
Revenues % of Nat'l Inc.	18	17	19	20

Receipts from Revenues and Borrowing

	Actual			Percent		
	1938-39	1939-40	1940-41	1938-39	1939-40	1940-41
Revenues	927	1,049	1,409	86	57	36
Borrowings:						
Small lenders†	75	109	449			
Large "		101	696			
Long & medium	75	210	1,145	7	12	29
Treasury bills	64	535	789			
Pub. dept. adv. etc.‡	14	34	541			
Total short-term	78	569	1,330	7	31	35
Total borrowings	153	779	2,475	14	43	64
Revs. & borrowing	1,080	1,828	3,884	100	100	100

Sources: National Income—The Annals (March 1941—Dr. Paul Studenski) and the estimates of the London Economist adjusted to the fiscal year period (see February 1, 1941 issue). Revenues, Expenditures and Borrowings—London Economist, Statistical Summary of the Bank of England, Foreign Commerce Weekly (December 21, 1940), and F. W. Paish in the London & Cambridge Economist Service.

* Based on newspaper reports. † National Savings Certificates, Defense Bonds and new Savings Bonds. ‡ Ways and Means borrowing of public departments and receipts of deposits from banks.

that a man who would have £5,000 ($20,000) left after payment of taxes would have had £66,000 ($264,000) income before payment. On the highest bracket the rate is 97½ per cent.

Deferred Credits Against Tax Payments

To mitigate to some extent the severity of these tax rates, the budget includes the innovation of a system of deferred credits to taxpayers. The essence of the plan is that the Government assumes an obligation to repay to both individuals and corporations a certain proportion of the taxes now levied upon them, and sets up for this purpose credits to their account in the Post Office Savings Bank, repayable after the war. Individual taxpayers will be credited with most of the increase in their taxes, up to £65 yearly, which results from the lowering of exemptions and the reduction of earned income allowance. As Sir Kingsley explained in the Commons, a married man with two children who earns the equivalent of $1,400 will pay about $98 in income tax this year instead of about $22 which he paid last year; but some $69 will be credited to him in a post office savings account. Corporations are similarly to be credited with 20 per cent of the 100 per cent excess profits tax paid.

Through this fiscal innovation the Government thus turns to the "forced saving" ideas advocated by J. M. Keynes, noted British economist. Under the original Keynes plan a graduated proportion of everyone's income was to be withheld by the Treasury, partly as taxes and partly as a blocked savings deposit. The aim of the plan, so far as it is unique, is to provide a definite reserve of purchasing power for consumers' goods in the post-war period.

Borrowings and Savings

The table shows that the actual deficit in 1940-41 was £2,458,000,000, while the estimated deficit for 1941-42 is £2,421,000,000. In the second part of the table the reader will find figures to show how the borrowing necessary to meet the deficit has been divided. In 1940-41 the sale of long and medium-term bonds yielded about £1,145,000,000, and £1,330,000,000 was raised on short-term.

To sell these securities the savings of the British people have of course been diverted as fully to the war effort as it is in the power of the Government and public opinion to accomplish; and inasmuch as new investment for non-essential purposes is halted the diversion is approximately complete. Even the reinvestment of a corporation's own earnings is practically checked by the high level of taxation, including the 100 per cent excess profits tax. Recently the national savings were estimated to be providing the Government with £100,000,000 a month.

In addition to current or "new" savings, the funds available for subscription to Treasury issues were increased by what was in effect borrowing from abroad. To a substantial extent payment for goods purchased within the Empire has been deferred, simply because Great Britain can no longer export on a scale sufficient to pay for her necessary imports. According to the London Banker, sterling balances of Empire countries are accumulating at present in London at the rate of about £150,000,000 annually, and are being loaned to the British Government under agreement with the Empire central banks. The commandeering of British overseas assets by the Treasury also provided the former owners of these assets with sterling, which was available for return into the Treasury through investment in government obligations; in effect, these past savings, long invested overseas, are being brought home to supplement the war effort. It has been due to this mobilization of savings, as well as to monetary policy, that the war financing has been carried out at a maximum cost of 3 per cent, against loans which cost 5 and even 6 per cent during the previous war.

Credit Expansion

Altogether, the Chancellor has estimated that the war cost during the first eighteen months amounted to £4,650,000,000, of which about £2,000,000,000 was met by taxes and £1,000,000,000 by overseas resources. Not all the remaining balance of £1,650,000,000, however, was covered by national savings. Other British authorities estimate that upward of £500,000,000, or roughly between 10 and 15 per cent of the total cost, was financed by borrowing from banks, which is the least desirable — because inflationary — method of raising funds. This is probably not an excessive expansion, especially as it was accompanied by an increased output of goods in the early months of the war.

The Rise in Prices

The real danger of price inflation comes from a public having more money to spend on fewer goods. The recent budget statement revealed that the wage increases in 1940 as compared with 1938 amounted to about £600,000,000, that expenditures for food, drink and tobacco were £325,000,000 greater. At the same time, the supply of goods available for civilian consumption is being curtailed.

Wholesale food prices went up 60 per cent during the first year and a half of war, despite the fact that the Government is reported to be spending £100,000,000 annually in subsidizing food production, holding down freight rates and extending price controls. The cost of living advanced about 26 per cent in the same period, causing an inevitable demand for wage increases.

Undoubtedly, a considerable part of the price rise may be accounted for by influences other than inflationary financing, such as the advance in ocean freight rates and the 15 per cent devaluation of the pound sterling in terms of the dollar shortly after the outbreak of the war. Nevertheless, the spiral of rising prices and costs has made progress, and the British public is naturally fearful that it may be accelerated by further credit expansion.

Whether the inflationary forces will be arrested by the heavier taxation and the effort to induce further saving is hard to foretell. Probably there will be critics to say that even the 1941-42 budget does not go far enough, and that a more radical revision of the tax system, including heavier taxes on services, amusements, etc., should have been imposed earlier. But inflationary trends appear to be slowed down, at least. The Lease-Lend Act, by relieving the strain on overseas purchases, makes it easier to deal with them. In any event the problem is plain: it is to reduce consumers' purchasing power by diverting it into the Treasury, as against the alternative of allowing it to be reduced by price advances, which would raise the cost of the war effort.

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